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Fiduciary duties: A third way?

John Machell QC and Jennifer Haywood examine the remedy of forfeiture of trustees' remuneration

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Case law provides us with examples of trustees being required to restore the value of a fund or pay compensation as a result of a breach of fiduciary duty, or to account for profits made from a breach of fiduciary duty, but there is a further remedy available against trustees which has been largely overlooked: forfeiture of remuneration.

That a fiduciary may forfeit their right to remuneration is well established in cases involving other fiduciaries such as agents or directors but, so far as we are aware, the principle has not been successfully deployed against defaulting trustees. In England, there is also authority to the effect that the profit share of a partner/LLP member is, in principle, capable of forfeiture if it has the character of remuneration: see *Hosking v Marathon Asset Management LLP* [2016], discussed later.

In this article we identify the criteria for forfeiture and the potential defences available to trustees, and consider how the courts might apply the principle in a claim against a trustee.

On what basis is remuneration susceptible to forfeiture?

A fiduciary may forfeit their right to remuneration if they act dishonestly, take a secret profit or effectively fail to perform at all: *Snell's Equity*, 33rd ed (2015), 7-062. Lord Alverstone CJ said, in *Andrews v Ramsay & Co* [1903], that:

> *A principal is entitled to have an honest agent, and it is only the honest agent who is entitled to commission.*

Lord Alverstone's reasoning – that the remuneration has not been earned – has been emphasised in a number of more recent cases. In *Stupples v Stupples & Co* [2012], HHJ Cooke recognised that 'the remedy of disentitlement to commission… can properly be described as a restitutionary remedy'. In *Stevens v Premium Real Estate Ltd* [2009], an estate agent forfeited its right to remuneration by failing to disclose material information to its principal:

> *'A trustee who places themselves in a position of conflict, accepts a secret profit or completely abrogates their duty to protect the trust assets may be at risk of having to repay their remuneration/fees.'*

> *The remuneration is forfeited because it has not been earned by good faith performance in relation to a completed transaction.*

As explained by the Supreme Court of New Zealand in *Stevens*, the restitutionary nature of the remedy means that there is no inconsistency in awarding both damages (or an account of profits) and refund of the commission/remuneration.

What defences are available?

It is said that there are two key defences:

- that the partner/member has acted in good faith;
- that the breach does not go to the whole contract; and/or
- it would be disproportionate or inequitable to impose forfeiture.

The first defence proved successful in *Keppel v Wheeler* [1927]. The defendants were estate agents who had been retained to sell a property. The agents procured an offer and communicated it to the owner, who accepted it, subject to contract. The agents then received an offer from the tenant but, believing that their obligation to the owner had come to an end, did not pass it on to the owner but did pass it on to the purchaser. The Court of Appeal held that the agents were entitled to receive their commission because they had misunderstood the extent of their obligations and thus acted in good faith.

However, the good-faith defence will not necessarily assist a fiduciary who has taken a secret profit. *Imageview Management Ltd v Jack* [2009] involved a claim against a football agent who had agreed to procure, and did procure, a UK club contract for a footballer from Trinidad and Tobago. The agent agreed with the club that, in exchange for a (fairly substantial) fee, he would arrange a work permit for the footballer. The agent was required to account for the secret profit to his principal, and was also held to have forfeited his right to commission/agency fees. The agent gave evidence that he considered the agreement with the club to be something completely separate to his agreement with the footballer and permissible. Jacob LJ stated expressly that it did not matter whether the agent thought it was all right to make the side deal (although it is clear that he doubted the agent's evidence on this point).

Imageview also illustrates how, although the remedy is restitutionary, it is available even if the fiduciary has performed a substantial part of their obligations. The claimant footballer had got what he had bargained for – a UK club contract. As Jacob LJ made clear, there is a policy reason at play:

> *The policy reason runs as follows. We are here concerned not with merely damages such as those for a tort or breach of contract but with what the remedy should be when the agent has betrayed the trust reposed in him – notions of equity and conscience are brought into play. Necessarily such a betrayal may not come to light. If all the agent has to pay if and when he is found out are damages the temptation to betray the trust reposed in him is all the greater. So the strict rule is there as a real deterrent to betrayal. As Scrutton LJ said in Rhodes's case 29 Com Cas 19, 28, 'The more that principle is enforced, the better for the honesty of commercial transactions'.*

A breach is less likely to go to the whole of the contract if it involves a long-term relationship instead of a one-off transaction. Hence, Vos J rejected the claim for forfeiture of a senior executive's salary and bonuses paid over a five-year period in *Governor and Company of the Bank of Ireland v Jaffery* [2012]. The executive had taken a secret profit on transactions involving one client but had otherwise diligently performed his duties over the five years of his employment.

Similarly, a claim for forfeiture of directors' remuneration failed in *Gamatronic (UK) Ltd v Hamilton* [2016]. The directors had established a competing business in breach of their fiduciary duties but the judge found that they otherwise complied with their obligations and promoted the interests of the claimant company.

However, in *Hosking*, an LLP member who breached his fiduciary duty by discussing a competing venture with four senior employees, but who otherwise fulfilled his obligations and indeed generated very substantial profits for the LLP, forfeited his share of the profits characterised by the tribunal as his remuneration. His forfeited profits greatly exceeded the damages he was required to pay.

The *Hosking* case is not authority on the question whether, and if so the extent to which, a particular share of profit can be characterised as remuneration for the purposes of the forfeiture rule as the claim was decided in an arbitration. It was only appealed on the question of whether the share of profit of a partner or LLP member can, in principle, be subject to forfeiture, but illustrates the potential risk that exists where there is a discretion afforded to the relevant court/tribunal.

Points for consideration for claims against trustees

A trustee who places themselves in a position of conflict, accepts a secret profit or completely abrogates their duty to protect the trust assets may be at risk of having to repay their remuneration/fees.

Although the trustee relationship is generally a long-term one, and it is perhaps unlikely that a breach of duty would affect the entirety o f their obligations, the relationship is perhaps one that requires trust and confidence more than any other and a court may regard a breach of fiduciary duty as completely undermining a right to remuneration.

Many cases are likely to turn on whether the remedy is considered disproportionate or inequitable.

If a trustee were to overcharge, they would be likely to fall into the secret-profit category of cases where the courts have taken a hard line: see *Imageview* and also *Avrahami v Biran* [2013], in which a joint-venture partner who misappropriated sums in excess of an agreed management fee was obliged to repay the entire management

fee. The hard-line approach is consistent with the court's reluctance to award an equitable allowance to fiduciaries who have acted dishonestly and/or accepted a secret commission (*Murad v Al Saraj* [2005]) and the policy reason emphasised by Jacob LJ (in *Imageview*, supra).

A forfeiture of fees directly related to a breach of duty is very unlikely to be disproportionate. If it is possible to sever the fees attributable to that part of the trustee's function in respect of which they have breached their duty – either because they charge an hourly rate, or because they charge a fee comprised of a number of elements – it may be possible to justify retaining the untainted fees. A disaffected beneficiary might therefore choose to limit the fees that they seek to recover, or at least present an alternative claim (cf the approach in *Governor and Company of the Bank of Ireland*).

Trustees may seek to exclude or limit the liability to forfeit their remuneration by seeking to exclude the operation of the principle in the trust deed. However, it is difficult to imagine how a clause might realistically be drafted to give the trustee an enforceable entitlement to charge even if the trustee fails to perform the core duty of a trustee, ie the duty to act honestly and in good faith, as this would effectively be abridging their duty beyond the irreducible minimum (*Armitage v Nurse* [1997]).

Conclusion for practitioners

The forfeiture principle affords disaffected beneficiaries the possibility of recovering fees in addition to recovering unauthorised profit and/or compensation. In some cases, the fees may be significant. Even if the fees in question are not that sizeable compared to the unauthorised profit or compensation, the recovery of fees paid to a defaulting trustee may provide a particularly satisfying addition to a claim, or provide some remedy where there has been a default but there is no demonstrable profit or loss.